DOW THEORY LETTERS INC.

RICHARD RUSSELL
P. O. BOX 15196
SAN DIEGO, CALIFORNIA 92115

Registered with the Securities Exchange Commission

40 Letters per Year — $50.00 Annually

THE MARKET: In a large red brick house about five miles from this office lives a famous prize fighter named Archie Moore. Moore was winning fights when most of today's "fighters" were kicking the slats out of their cradles. Moore still climbs into the ring on occasion, and any fighter, young or old, will tell you that Moore is a hard man to beat even today. But Moore is obviously past his prime, and his friends shake their heads when he fights now, because they remember the old days when nobody in his right mind (particularly if he had a title to lose) would tangle with Archie.

This bull market and Archie have a great deal in common. The last bull market highs were recorded (see Chart 1) by Rails in October at 224.91 and by Industrials in November at 891.71. Subsequently, the two Averages retreated to mid-December lows. A little rally followed, and during the last week of December Rails again declined, breaking to a fresh low of 203.51. Industrials refused to confirm, holding well above their December 15 low of 857.45. This non-confirmation set up the technical conditions for the rally now in progress. It should be remembered that the Averages registered their last joint highs in October, almost three months ago. Therefore, the recovery now in progress should serve to fully correct all the ground lost since then.

As the rally progresses, all eyes will be focused on the 1964 highs. If the two Averages can better their respective 1964 peaks of 891.71 and 224.91, the market will be saying that the bulls are back in the saddle and that the Great Society will have many more weeks if not months of "clear sailing." Conversely, a breaking of the December lows of 857.45 and 203.51 would signify that the short-sellers, not the optimists, have been correct in the appraisal of the economic picture.

In recent Letters I have drawn attention to the 30-week moving average (MA) of Industrials (Chart 1) which now stands at 856. The Industrials have held above the MA for over two years, and it is noteworthy that even the "Kennedy assassination panic" resulted in only a two-day penetration of the MA. At the recent December low and again at the January low, Industrials dipped to within a few points of the MA, but so far they have refused to drop below that critical guidemark.

There are many who look upon the current performance of the market as being clearly bullish, and it is true that from a Dow Theory standpoint, nothing has yet occurred which would cause the market student to lose a night's sleep. But this writer must deal with both the trend of the market and the probability of making money in the market at any given time. It is in the latter sphere that Wall Street may be likened to the aforementioned Mr. Moore. For although this is a bull market until proved otherwise, the bull is tired and well past his prime. The bull needs more than a simple "pause" or a "rest," and although I would not want to "fight" the market by being on the short side (yet), I also feel that the market lacks the vitality needed to produce reasonable profits — particularly when weighed against the risks now involved.

The Composite Chart shows the DJI Average and the S & P "425" both pushing back within their long trading ranges. The A-D ratio, having held fractionally above its August low, is now working its way up off its December bottom. The 10-day averages of advances and declines have crossed over to the plus side again. Having "topped" twice at the 100 level, the still-sluggish 5-day average of daily new highs will be worth watching carefully during this latest rally. Odd-lots showed their normal (tax) selling bias during late December and are now showing their normal (reinvestment) buying bias during early January. There has been little

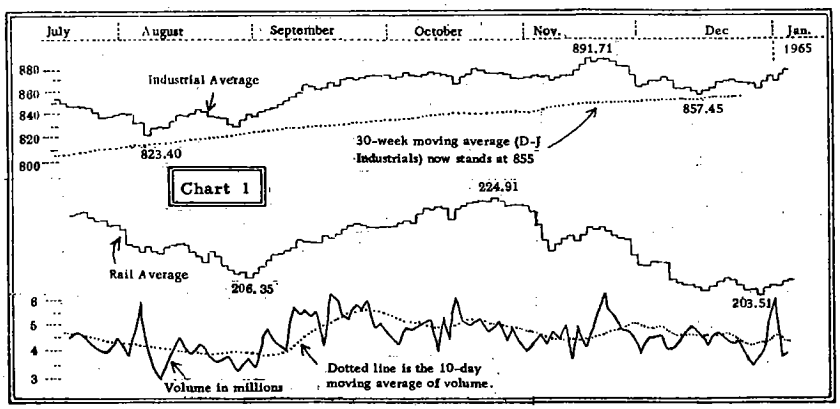
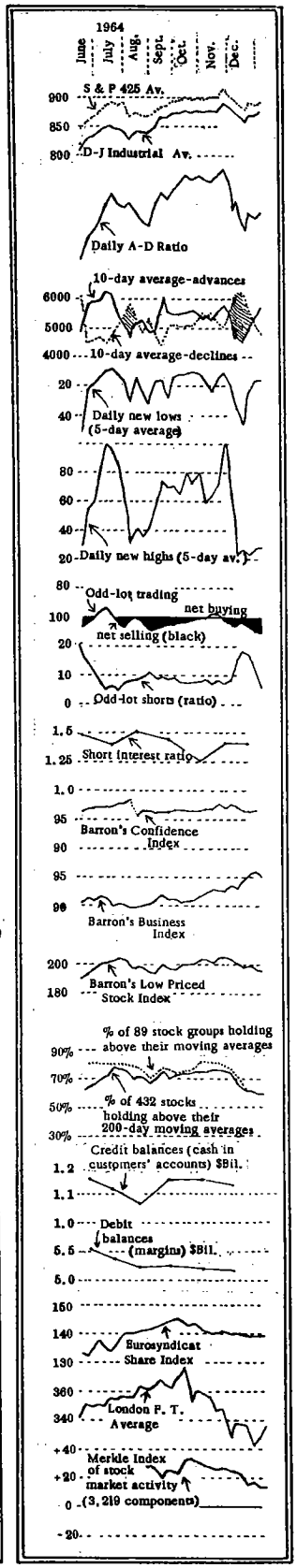


Chart 1



change in the remainder of the indicators, and in this the indicators are undoubtedly reflecting the rather exasperating lack of real change in the market itself.

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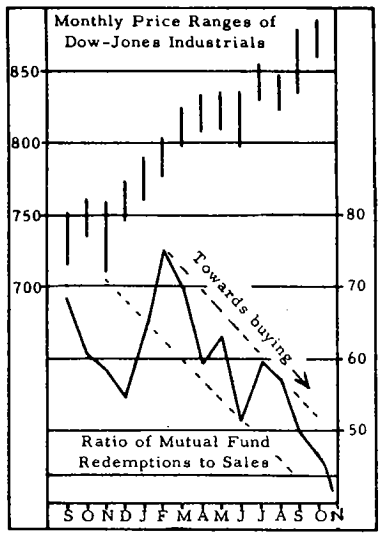
In Letter 273 I included a chart (courtesy of Drew Odd-lot Studies, 50 Congress St., Boston, Mass.) which traced the ratio of mutual fund purchases to redemptions. I have up-dated this chart, and the latest (November) figures show extraordinarily heavy fund buying in relation to redemptions. These figures would seem to fortify my contention that the public is increasingly bullish on mutual funds and the "market in general" but bearish on their own ability to select "the right stock." The fund ratio has now dropped to its lowest level since mid-1962.



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With the S & P "425" closing the month of December at 89.12, the Momentum Index has now dropped to a new low of 112.5. I am indebted to the chart department of The Dines Letter for pointing out my error in my MI computation in Letter 273 (for the MI was 115 at the end of November, not 113 as stated). New subscribers may send stamped, self-addressed envelopes for copies of Letter 268 which describes the MI.

KAFFIRS: A subscriber (S) speaks: Russell, it's a new year, and from your Letters I gather only too plainly that it could be a tough one. Now don't repeat that you're not optimistic about making money in this market. I read all your Letters, and I got your message months ago. But what do you like here? There must be something you would do besides "play it safe." Look, I'd like to know what you're doing yourself. What, in your own opinion, constitutes an intelligent speculation?

Russell (R): All right, I'll give you my ideas regarding an intelligent speculation. I've bought these myself, and I like them, but I want you to remember that this is just my own opinion, and a lot of things could go wrong in this particular area.

S: Fine, never mind all the apologies and "escape hatches." I realize that everything in the market is a risk — so shoot.

R: I like the South African gold mining stocks (known as the Kaffirs).

S: Yes, you've been recommending those in your Letters over the past few months. So you really like them. What reasons can you possible come up with for buying gold mining stocks in that crazy part of the world?

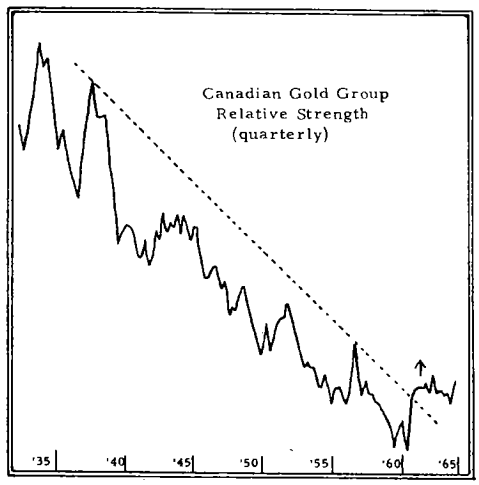
R: I'll give you my reasons, and you can make up your own mind. (1) The public, the majority of brokerage houses and most professionals are totally ignorant of the gold problem and the implications of a possible rise in the price of gold.

(2) Furthermore, large brokerage houses and financial institutions are probably not even in the position of being able to recommend purchase of gold shares. To recommend gold shares is to imply that devaluation is a probability. Obviously, large institutions do not want to go on record as being "in favor of" devaluation.

(3) Institutions and funds have not purchased gold shares themselves, and one reason is that the gold issues are so "thin." For example, the total floating supply of Campbell Red Lake and Dome together (two leading Canadian issues) is only about 3.5 million shares. However, the Kaffirs have large capitalizations, so that if the funds do finally decide to buy golds, these could well be the stocks they will buy.

(4) It has been a generation since the last international monetary crisis. The investing public and most professionals have absolutely no "feel" for the gold problem or for monetary problems in general. They have been trained for thirty years to look at securities in terms of simple production, sales and profits. Thus, the gold shares have fallen into great disrepute. If a real demand for gold shares should appear, it could have a long way to go (since everybody is now "out of the golds").

Mr. S. interrupts: Yeah, "should appear," but when? You can wait forever with the wrong merchandise on Wall Street.



(5) The demand is beginning to appear now (did you note Campbell Red Lake on the "most active" list on December 31?) As a matter of fact, I am including a rare chart (courtesy of Ray * Signals, 141 B'way, N.Y.C. 6). This chart shows the relative strength (RS) or popularity of the Canadian gold group dropping from a peak in 1934 to a 27 year low in 1961! Any group which has dropped steadily in popularity for 27 years can be said to be literally "despised" by investors. The implication of this is that the gold group is "sold-out" (meaning that anyone who owned these shares over the past three decades is now disgusted with them). When a group is as sold out as the golds are, it is often in a position to undergo a dramatic upside reversal (we saw this happen recently in coppers, leads and zincs). But if the Canadian golds are sold-out, the Kaffirs are even more so. I need not go into details regarding why investors are afraid of the S. African golds. By the way, note that the chart also shows what

could be a monumental reversal in the 27 years downtrend in Canadian gold's RS. The implications of this reversal has to be bullish to some extent for Kaffirs.

Mr. S. interrupts: Why is this necessarily bullish for Kaffirs?

R: Because about 71% of the Free World's gold is produced in S. Africa. That's where the gold really is. However, it is true (and it is a plus for those who are buying Kaffirs now) that the very word "Africa" strikes fear into the heart of the average investor. Nevertheless, here is one of my chief contentions. I believe that S. Africa is in very much better shape than investors have been lead to believe. And I am talking not only about the general position of S. Africa but about its negro-white problem. I know all about apartheid (separation of the races); it is detested by most of us, but it exists there, and there is nothing we can do about it. That is the worst view. But did you know that with the bloody recent rioting in Africa, S. Africa has actually become a haven for both whites and blacks? I strongly urge you to read the brilliant December 28 front page editorial in Barron's. In this piece the Editor notes that during 1964, ten thousand white refugees and one million negro refugees flocked into S. Africa to escape the dangers from the north. Thus, although apartheid is abhorrent, it is obviously preferred by a great many whites and blacks to that which is being served up in the rest of Africa. Did you know, by the way, that even during the race riots of 1960 in S. Africa, not a day's work was lost in any of the mines?

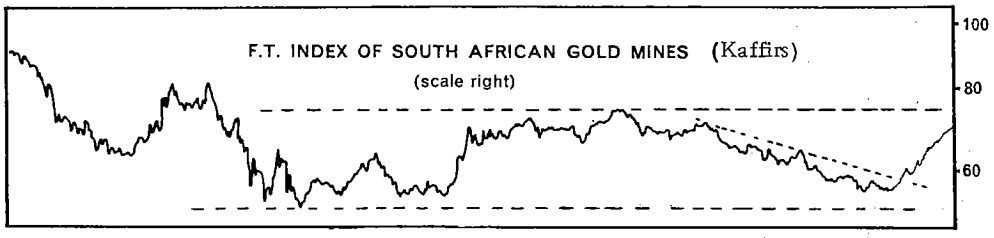
I don't want to appear to be painting a picture of perfect bliss, but living conditions for S. Africa's negroes are the best on that continent. The mines have adopted a paternalistic attitude towards their workers, and housing, medicine, etc. is provided. There is no question but that S. Africa labors under mighty problems, but I feel that the positive side is relatively unknown.

The S. African stock Average over the past few years has been about the strongest in the Western world. South Africa has been enjoying a great economic boom. The country has a very stable government; it is self-sufficient in almost everything except aircraft and oil. South Africa is now planning to produce its own aircraft, and if nothing else, it can buy communist oil in exchange for gold. Exchange reserves in S. Africa rose from a low in May, 1961 (when S. Africa seceded from the Commonwealth) to a 15 year high of $770 million in September, 1963. In August, 1964, reserves were still $730 million. Gold production in the first 9 months of 1964 climbed 5% to a record 21 million ounces. Nevertheless, agriculture and industry account for a larger share of the national income of S. Africa than gold. To give you an example of S. African strength, you might note that the recent $630 million Orange River hydroelectric project was financed entirely by S. Africa itself — without any outside aid.

All in all, it is my contention that as interest focuses increasingly on gold, there will be more study of the entire situation and a gradual realization that S. Africa is actually a safer and more stable nation than most investors realize.

Mr. S: All very interesting, even though the conclusion is strictly your own opinion. But what about the Kaffirs?

R: We almost forgot the Kaffirs themselves. Here's what has happened. Because of political fears, the fabulously rich Kaffirs are now selling at extremely low valuations. Even if the price of gold were never to be increased, the S. African gold shares would still appear to be "cheap" growth situations. In fact, many of the Kaffirs are now selling at 5 to 10 times earnings while yielding 6 to 10%. The accompanying chart (courtesy of The Investor, 50 Denmark Hill, London, S.E. 5) shows the Kaffir index forming a huge "triple bottom" during 1961, 1962, and 1964. I consider the whole 1961-64 area, within the dashed lines, to be one huge potential base from which a major rise can be mounted).



It should be remembered that the investor who buys Kaffirs will receive a fat yield while awaiting two speculative possibilities: (1) a gradual investor acceptance of the great values represented by Kaffirs, and a subsequent rise in the price-earnings ratios of these stocks, (2) a rise in the price of gold. I might add that Canadian gold shares have already discounted to some extent a possible rise in the price of gold, and of course, they already enjoy a certain amount of investor acceptance. But if Free State Geduld, for instance, were to be appraised at the same P/E ratio as Campbell Red Lake (and Free State is a vastly richer property), it would sell for 80 instead of its present 20.

Mr. S: I see; in other words, the Kaffirs represent high political risks, but they also represent great leverage both because they are so "cheap" and because the price of gold could be raised.

R: Correct, and you should remember that if the S. African political situation were perfect, these stocks would be selling at double to quadruple their present prices. The opportunity in these stocks stems from investors' ignorance of the gold and monetary situation and of their further fears (right or wrong) about the S. African situation. If gold is revalued and if investors "revalue" the S. African situation, then the Kaffirs will no longer be potential bargains. This is how great speculations are born. Finally, I submit that in my opinion, forces are at work which favor a rise in the price of gold. I further believe there is going to be a favorable reappraisal of the S. African scene.

Mr. S: Another question; what do you make of monetary expert Franz Pick appearing last week on the widely-watched Huntley-Brinkley TV show? On that show he predicted a British and then a U.S. devaluation.

R: Again, this is strictly a guess, but that could have been a typical Administration "feeler." A controversial statement goes over the air, and the results are studied. If there is no outcry, then the "controversial idea" becomes a possibility. This writer, by the way, heard no popular outcry against the Pick prediction.

Note: As I write two more interesting items have appeared. The January 6 issue of Financial World carries a feature story on golds. Secondly, France has announced that it is stepping up its regular monthly (about $36 million) withdrawals of gold from the U.S., and France also states that they are not ruling out large lump withdrawals of gold. France now has a potential $1.3 billion in dollars which could be converted to gold. Evidently, DeGaulle is getting nervous about the monetary situation and is politely announcing that he is "moving towards the exits."

The following report was worked out by my good friend Robert Powers of San Diego's Eastman Dillon office. Powers was formerly with the Security Analysis Department of Bank of America:

WELKOM GOLD MINING (SOUTH AFRICA)

APPROXIMATE PRICE: 5½ **YIELD: 7.6%**

Company is one of the few long-life mines in South Africa which affords a considerable amount of downside protection (due to an attractive yield and a steadily increasing rate of production, which should lead to higher earnings and dividends) along with a considerable amount of leverage in the event of devaluation (due to high operating costs). The company is well-represented in the portfolio of the American-South African Investment Co., which held 517,500 shares as of August 31, 1964. The shares are traded on the London and Johannesburg stock exchanges, and are available to American citizens through A.D.R.'s, which are traded in our over-the-counter markets. The 15% interest equalization tax may be avoided by purchasing A.D.R.'s from another American.

STATISTICAL SUMMARY

Year	Net Profit (Rands)	Gold Produced (oz.)	Ore Reserves (tons)
1963	5,031,000	558,273	5,203,000
1962	3,586,000	467,599	4,748,000
1961	2,597,000	381,754	4,322,000
1960	2,765,000	373,690	4,158,000

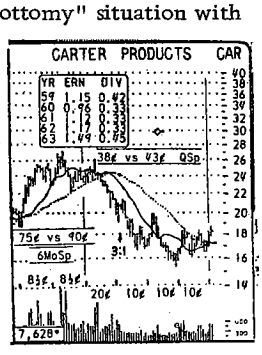
POSSIBLE EARNINGS EXPANSION IN THE EVENT OF DEVALUATION

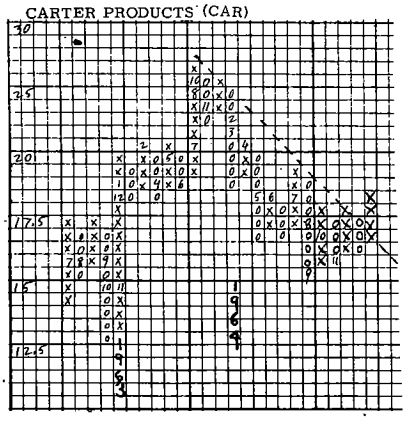
	"Cost Per Ounce" Approach		
Gold Price (per oz.)	$35	$70	$100
Production Cost (per oz.)	-28	-28	- 28
Profit (per oz.)	$ 7	$42	$72
Potential % increase in share price:		500%	928%

NOTE: Dow Theory Letters holds a position in assorted Kaffirs among which is Welkom. Another Kaffir which compares very favorably with Welkom and which is recommended is Western Deep Levels, "A" shares.

LATE NOTES: As this is written (Thurs., Jan. 7, noon) the market is slightly higher and obviously still in its recovery phase. The price of gold in London has climbed to a new high since 1962, and the gold shares are again bouncing around their highs.

President Johnson is giving first priority to medicare, and he wants to start building on 32 medical centers around the nation. This is and will continue to put the medical and drug stocks in the limelight. Such medical issues as Am. Hosp. Supply and Ipco are already selling in the 20 times earnings class. Drugs, however, after a group relative strength correction of over a year, are beginning to look like a turn-around situation. Of the 12 drugs in the Traders Research chart book, 8 now showing rel. strength lines which are clearly bullish. For trading purposes I like Carter Products. (P & F chart courtesy of Chartcraft, Larchmont, N.Y.) CAR just turned bullish at 18½ and shows a P & F "count" of 26. The small weekly chart (courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas) shows a "bottomy" situation with the stock now moving well above the short and the long-term moving averages.

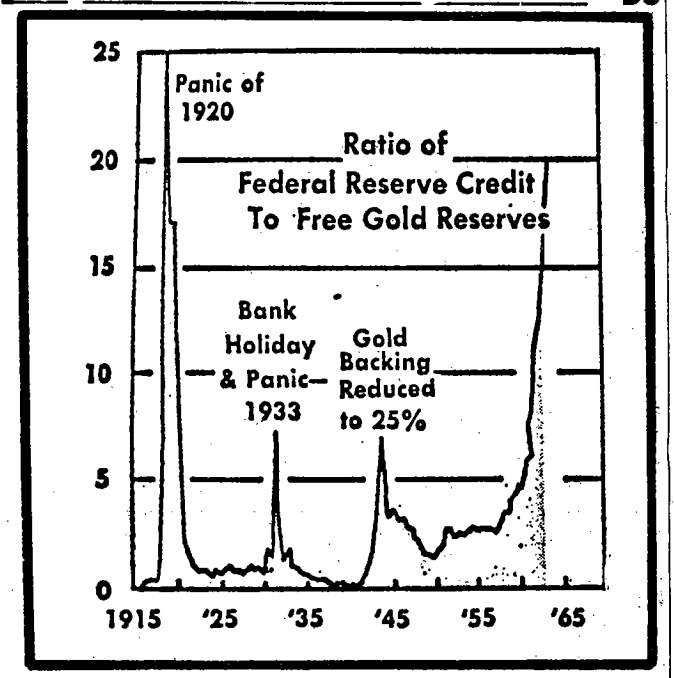




OF INTEREST: Latest S.E.C. report shows these interesting "insider" transactions: officers are selling Abbot Labs., Cerro, Int. Paper, heavy selling in Time, Inc., Arlan's Dept. Stores, United Airlines. Buying continues in Foremost Dairies, heavy buying continues in W.T. Grant (I recommended the latter two, and I still like them). Alfred Perlman, Pres. of N.Y. Central, continued to unload this stock, selling 4,700 shares of CN in Nov. thus reducing his total holdings to 10,000.

I have reprinted the article below as I believe it will be of interest to my subscribers.

THE SAN DIEGO UNION
FINANCIAL NEWS
MONDAY MORNING, JANUARY 4, 1965 ④ B3



$35 PRICE ARTIFICIAL

Gold 'Reserve' Ratio Declines

By RICHARD RUSSELL
Publisher, Dow Theory Letters

"Without justice," wrote St. Augustine, "what is a state but a great robbery?" And these words must closely echo the thoughts of the holders of gold bullion and gold shares over the last three decades. For while the price of everything from celery to steel has been rising since 1934, the price of gold has been artificially pegged by the U.S. government at $35 an ounce.

Nevertheless, as the new year is ushered in, events are rushing towards a conclusion which may provide the highest fiscal drama in a decade. By law the United States must hold gold equal to 25 per cent of the total of Federal Reserve credit (deposits and liabilities).

If this so-called "reserve ratio" drops below 25 per cent, then either the total reserve credit must be contracted (which would be severely deflationary) or gold reserves must be increased.

Over the last few weeks, the reserve ratio dropped under 28 per cent for the first time in modern history. Thus, we are fast approaching the point where action must be substituted for words. One school is for removing the entire 25 per cent backing clause, thus freeing all our gold for foreign claims (which are mounting steadily).

But the psychological effects (if nothing else) of such a drastic step and the resultant potential cries of "paper money" may be more than the "Great Society" wants to face at this time.

* * *

BUYING U.S. silver dollars, pay-ing $1.05 per coin, any condition, any date, any amount. Other U.S. coins also wanted. Coin Mart, 825 Broadway, 232-3653.

Gresham's famous Law, formulated around 1579, stated that "bad money drives out good money." Few people realize that they are watching a dramatic application of Gresham's Law in today's silver crises. The silver crisis has two sides: (1) there is a shortage of substitute coins, and (2) there is a shortage of silver for commercial use. With the probability that the silver content of our silver coins will be reduced or eliminated, silver coins are now being hoarded by both silver speculators and by collectors. If you don't believe it, read this little squib which has been appearing daily in our San Diego Union newspaper. The spector of a base coin is now driving good silver money out, and we are thus witnessing Gresham's ancient Law in action.

Meanwhile, one of Britains's leading banks has just investigated where the Free World's gold has gone over the past 13 years. Of the $16 billion total supply (of which about $2 billion came from Soviet sales), the bank estimates that $9 million went into private hands and less than $7 billion went into monetary reserves. What would bring out the private hoards? A higher price for gold, and world monetary stability.

A second possibility, and one which is being given increasing prominence, is a major rise in the price of gold. As seen on the accompanying chart, the ratio of Reserve credit to free gold reserves is now stretched further than at any time since the 1920's. Indeed, it has reached the point where (in the past) drastic action was forced upon the country. But if the current price of gold was doubled to $70, the current $2 billion in free gold would increase to $18 billion and the ratio which is now at a dangerous 20-to-1 would drop to 2-to-1.

Thus rather than a dog-eat-dog unilateral (forced) devaluation by say Britain and then the U.S., it is increasingly possible that a general pre-agreed rise in gold by all the leading powers of the world may take place.

* * *

What would be the objections to such an "agreed" rise in the gold price? Actually, it is becoming increasingly apparent that there would be very little objection to a multilateral price increase. such a move would grealy increase the Free World reserves, and thus not only relieve the current pressure on many central banks, but it would allow for another potential great expansion in paper money (the greater the gold base, the greater the potential supply of money).

It is in this area that the possible objections to a rise in the price of gold might crop up, for with a new expansion in the paper money supply would come renewed inflation. Nevertheless, few are the politicians who would not vote for inflation as an alternative to deflation or even "living within one's means."

* * *

What else might occur if the price of gold was raised? An extraordinary result would be that the eyes of the world would immediately turn on the Union of South Africa. For it is here that 70 per cent of the Free World's gold is mined. The South African gold mining shares (known as Kaffirs) are selling at only 5 to 10 times earnings and are in many cases yielding 6 to 10 per cent. Already these "scare-depressed" stocks are rising in anticipation of the possibility of a rise in the price of gold. But to the investor, South Africa smacks of race-riots, witch doctors, jungle drums and persistent wars.

This view, however, could prove to be one of the costliest misconceptions in the investment community. For the Union is one of the strongest nations of the Free World, and despite is policy of apartheid (which is abhorrent to most of the West), it is nevertheless a fact that the black workers of South Africa (who are residing there of their own free will) are living under the best conditions now offered on the "Dark Continent."